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# 1 Background

Pension provision forms the largest part of social protection and due to the ageing of population, its significance to the whole society will further increase. Pensions are already the main source of income for around a quarter of the population. Especially the earnings-related pension provision has increased its importance as the means to securing income maintenance.

Pension expenditure in relation to GDP is almost 12 per cent, and this share will increase in the next few decades due to population ageing and gradual maturation of the earnings-related pension schemes. Growing pension expenditure will also mean an increase in pension contributions even though the pension funds will reduce the pressure to raise the contributions.

Both the socio-political obligations and the economic effects of pension provision are considerable. The broad scope and the manifold aims of the system result in a wide range of research topics. Among all these important topics the most important ones, which can be studied with the available resources, have to be distinguished.

A general goal in the strategy of the Finnish Centre for Pensions is the evaluation and the follow-up of the effects of pension reforms. A particular starting point in the research programme is the pension reform of 2005. For instance the development of effective retirement age and the factors influencing it are relevant research issues from the viewpoint of both the pension system and more generally the whole social policy.

Evaluating the effects of reforms also serves future development of the system. In this development task the horizon often lies several decades ahead in the future. In that case we have to be able to predict social trends far into the future, and to evaluate the pressures they will cause for pension provision. Changes e.g. in working life may be quite rapid, which requires quick reactions in research.

**FACTORS AFFECTING PENSION PROVISION**

Population ageing: effects on pension expenditure and economic growth  
Persistence of structural unemployment  
Efforts to increase employment  
New profile of incapacity for work  
Increasing labour-market mobility  
Fiercer international tax competition  
Increasing role of the EU in the field of social protection  
Interplay of statutory and supplementary provision: economic and political background factors

The credibility of the pension system rests on both social and financial sustainability. Sufficient pension provision for future generations is the cornerstone of social sustainability. In order to be able to achieve the welfare goals of pension policy, the pension system also has to be financially sustainable.

Financial sustainability will be further emphasised in the future by the change in the age structure, which will make it more difficult to increase employment rates in the next few years. The amount of working-age population will already begin to decrease in a few years time, and after this the Finnish population will be ageing at record speed until 2030 in comparison with the other EU countries. The internationalisation of businesses and the increased mobility of production factors have also caused pressures to reduce social insurance contributions in the EU countries. On the other hand, Finland is in a more favourable position due to the pre-funding of pensions in preparation for the future increases in pension expenditure.

Financial and social sustainability go hand in hand. Therefore the research should monitor the pension system from both two viewpoints. It is essential to contribute to the overall objective that also in the coming decades the pension scheme will maintain the balance between adequate pensions and sustainable contributions.

## 2 Research guidelines

### *Factors affecting staying at work and retirement*

Pension and employment policy aim at longer work careers. A clear shift has rapidly taken place in the Finnish pension policy from favouring early retirement to promoting staying at work. Starting in the 1990s, pension policy reforms have encouraged to longer work careers and to maintenance of work capacity. The gradual reduction of early retirement pathways culminated in the pension reform of 2005.

Besides reducing early retirement pathways, the 2005 pension reform introduced a flexible retirement age and improved financial incentives for staying at work. Work careers are expected to lengthen already in this decade, although significant effects are only to be expected in the long term. Right from the initial years of the pension reform it is necessary to monitor the impact of the pension reform on lengthening work careers and the effects of incentives on staying at work. The main issue of interest is the effect of the pension reform on employment of elderly workers and the effective retirement age. The research will pay attention to whether the development varies between different sub-groups of the population. The developments should be compared between employees and self-employed persons, people with different educational backgrounds, and people working in different occupational sectors.

However, the pension scheme is not the only factor affecting early exit from working life. Therefore the research should also look at other explaining factors. In addition to work capacity, these factors are connected to working conditions as well as to attitudes of the employees and of the employers. Also the effects of family structure,

income and wealth on the choice of time of retirement are not yet well understood. Research on the effects of different types of savings on retirement is also needed.

Combining work and pension before retiring on an old-age pension has become more common, especially due to the part-time pension. The partial disability pension also makes it possible to reduce work input towards the end of the working career. Different types of partial social security benefits attract a lot of interest, and thus it is worthwhile to study their effects. The studies investigate whether the aims of longer work careers and decreasing numbers of full-time disability pensions are realised through the before mentioned means. The combination of work and pension is an increasingly significant research issue because, following the pension reform, new pension rights accrue also from work alongside the old-age pension.

### ***Work ability and rehabilitation***

The population share of recipients of a disability pension has decreased during the last couple of decades. However, the factors affecting the use of this type of pension are becoming especially interesting. Following the pension reform, the significance of the disability pension will increase as other early retirement pathways are cut off. The contents of work ability are also changing. At the beginning of the 1990s the largest disease category as the ground for a disability pension was still the diseases of the musculoskeletal system. Nowadays, however, the most common reason for new pensions is one from the category of mental health. Especially the number of disability pensions granted on the basis of depression has risen rapidly. A new kind of incapacity for work calls for new preventive and integration measures. Knowledge on work ability in

different population groups, different dimensions of work ability and development of the contents of work ability are important for both the functioning of the disability pension scheme and the supporting of work ability. Identifying the factors that affect work ability and understanding the meaning of work ability for persons of different ages also help to predict future developments.

The aim of preventing disability and maintaining work ability is clearly visible in rehabilitation activities. The purpose of rehabilitation within the earnings-related pension system is to help the individual to continue in working life despite the illness. The changes to the legislation on rehabilitation, which entered into force in 2004, strengthened the role of rehabilitation: on certain conditions the employee is entitled to vocational rehabilitation. The legislative strengthening of rehabilitation within the earnings-related pension scheme also increases the need for research in this area. It is important to evaluate whether rehabilitation promotes staying at work and whether it generates savings on pension expenditure.

The research strives to answer the questions how, and through which pathways people become selected for rehabilitation, whether there are problems in evaluating the criteria for rehabilitation, and what kind of rehabilitation the clients are steered towards. Research is needed especially on whether the means in use in vocational rehabilitation meet the needs of today's and tomorrow's working life, and whether the new kind of disability requires changes in the rehabilitation. Understanding the threat of disability, and finding means of detecting it at an early stage, need the support of research based knowledge.

***Comparative research on pension provision and the role of the EU***

Pension policy cooperation between the EU countries has rapidly increased in recent years. Deeper economic integration has been followed by a need to increase cooperation between the EU countries also in employment policy and in the area of social policy. The aim is to improve economic competitiveness and increase social cohesion.

This takes place mainly through means of political cooperation. In economic, employment and social policy the common goals of the member states are agreed on at the EU level. On the basis of these, each country draws up national action plans and the achievement of the goals are monitored at the EU level. Henceforth the goals of all these policy areas will be reviewed simultaneously every three years, whereby they can be coordinated. This means further deepening of cooperation at the EU level. In the area of social policy it is especially the reforms of the pension schemes that have become a central area of cooperation.

It is important to monitor and evaluate pension policy decision-making at the EU level. Research helps to assess how intensive and effective the future cooperation will become and whether the pressures to harmonise the schemes will become stronger. It is also necessary to study how pension provision and, more widely, social protection are changing through cooperation between member states with different histories and outlooks for the future. Moreover, there is also a reason to evaluate especially the internal development of pension policy in the large EU member states, because the significance of these countries is crucial when defining goals for EU pension policy.

Pension policy cooperation generates a lot of data for comparative research on pension provision. The growing amount of comparative data also increases the need for research analysing this data to counterbalance the use of superficial comparisons, which often lead to misleading conclusions. In any case, the 11 pension policy goals agreed on by the EU countries will direct the social debate regarding pensions. One task of pension research is to produce scientific knowledge to support the debate on how to achieve the agreed common goals.

Closer pension cooperation increases the need for information on pension reforms in other countries. Attention should also be paid to the pension policy choices of the new member states in the Central and Eastern Europe. These choices place substantial emphasis on funded and notional funded pensions. Other interesting topics are the economic areas competing with Europe, and the level and development of their social protection. The integration of the whole global economy and its effects on social security systems may in the long term also affect the planning of Finnish social protection and pension provision.

### ***Adequacy of pension provision and income for pensioners***

Achieving sufficient earnings-related pension provision is a basic goal of the scheme. The research will monitor the realisation of this goal. The increasing population share of pensioners, for its part, emphasises the significance of this research.

Earnings-related pension provision should guarantee a reasonable living standard after retirement. In Finland the target has been, after 40 years of work, a pension level of 60 per cent of the previous earnings. The total amount of pensions accrued from different employment



contracts has also been restricted to this level. In the reformed pension scheme this target level is no longer a similar indicator as before. The abolition of the 60 percent cap on the replacement rate and the increase of the accrual rates towards the end of the work career make it possible to accrue better pensions than before. Moreover, the flexible retirement age gives the individual's own choice of retirement age a significant role when determining the level of pension benefit. The development in the level of pension provision is naturally also affected by many other changes in the pension scheme, e.g. the introduction of the life expectancy coefficient.

Research on income for pensioners should also pay attention to the phenomenon of permanent low income level, and the reasons for this. This issue is affected by the fact that a considerable proportion of unemployment is long-term or recurrent. The share of unemployed workers receiving the minimum unemployment benefit has increased sharply, and this is also reflected in the future earnings-related pensions.

The aim of the pension reform to promote pensioners' employment is also linked to labour market issues. The motive for employment may be insufficient income, willingness to continue working, or a mixture of both of them.

In addition to the level of pension provision the economic well-being of pensioners is affected by many other factors, such as taxation as well as health and other welfare services. The trends in saving and wealth are also important. The development of the level of pension provision should also be monitored in relation to these factors.

The new pension calculation mode based on annual earnings is taken into use in the case of employees who are covered by the employees pension act TEL. Therefore it is useful to direct research more towards earnings profiles instead of employment contracts. The reform also tightens the connection between pension provision and other social protection, as pension accrual for periods of childcare

and other so-called unpaid periods is changed. This interaction should also be evaluated in the studies.

In both the private and the public sector the growing economic competition maintains requirements of efficiency. The need for part-time and temporary work may also increase. These factors are reflected in the labour market status and the pension cover by gender. Therefore there is a reason to study the pension provision by taking the gender issues into account.

### ***Financing of pension provision***

Interest in the financing of the pension scheme has increased simultaneously with the ageing of the population. The sustainability of the financing is an interesting issue not only for the pension scheme but also for the long-term planning of the rest of the public sector, of private households and of companies, for the international competitiveness and for the other members of the EMU.

At the Finnish Centre for Pensions the long-term trends of pension expenditure and contributions are evaluated with the help of the so-called PTS model. It is possible to calculate alternative potential future scenarios using different assumptions on for instance fund yields and effective retirement age. The results show among other things how strongly the increase in the pension contribution will depend on these two factors.

In addition to these calculations other types of research on the financing of pensions is needed as well. Closer international cooperation in pension field has created more interest in other countries' schemes and the effects of them. Issues traditionally studied in international theoretical research include both the choice between a funded and a pay-as-you-go (PAYG) scheme, and the transfer from one scheme to another. Lately there has been a lot of

interest in reforms where the defined-contribution principle has been increasingly applied in determining benefits within a PAYG scheme (so-called notional defined contribution scheme NDC). Also the so-called automatic stabilizers have risen to the fore both in theory and in practice. They are predetermined rules of action which affect either the level of pensions or index revaluations if there is too much pressure on the financing of pensions.

Participation in the international cooperation and pension debate requires monitoring the reforms also in other countries and the research related to them. The research aims at learning to understand profoundly the effects of different types of schemes. It is important to evaluate for instance how the risks are distributed between generations in these schemes.

The sustainability of the financing of pensions is affected by the developments in employment rates. Employment rates are, for their part, also affected by the pension scheme: incentives for individuals to continue working and incentives for companies to recruit or to lay off personnel of different ages. So far domestic studies investigating financial incentives have concentrated on retirement decisions at the individual level. In addition to this it is also necessary to study the demand side of the labour market. The decisions of companies are naturally highly important for employment among ageing people. Therefore it is useful to study the companies' incentives to hire or to lay off employees of different ages. A main part of these incentives are the ones inherent in the pension system, that is, the level and the structure of pension contributions. In addition to the costs, an interesting research issue is the employees' productivity at different ages.

### **3 Data issues and research methods**

In Finland there are good possibilities to use the extensive register data for research purposes. The so-called panel datasets, which include data on the same persons for several years, and which can include combined data from different registers, have proven to be especially useful. These datasets include information for instance on wages, employment contracts and pension accrual. Moreover, a good starting point for empirical research is provided by the wide coverage of the social security and the advanced state of information systems.

A new register based research dataset will be obtained for research on changes in pension provision and working life. For this purpose a large sample representing the working-age population is selected. Data from registers administered by Statistics Finland, and the data from the employment and pensions registers of the Finnish Centre for Pensions are added to it. The dataset is used for instance to study transitions in the labour market. These transitions to be investigated include retirement as well as transitions between employment and unemployment, and transitions between employment and self-employment. The aim is to make it also a so-called linked employer-employee dataset. This linking means that a connection is created between individual and company data through a company code linked to the persons in the dataset. With this type of data we can then monitor for instance what type of recruitments (e.g. as regards the persons' age and level of education) different companies (e.g. according to industry and company size) undertake.

During the period of this research programme also new cross-section datasets can be used in many ways. Important datasets of this type are for instance Working Conditions 2003 (Työolot 2003) dataset, the dataset of Flexible Retirement Age (Joustava eläkeikä)

survey for employees, and the corresponding interview data for employers. The dataset of the most recent wealth survey is also available. Intensive use of Health 2000 (Terveys 2000) dataset continues especially in research projects related to work capacity.

Pension reforms may provide us with interesting cases of so-called natural experiments. A natural experiment refers to a situation where otherwise comparable individuals have for instance different incentives or, regarding early pensions, different age limits in different years due to the pension stipulations. By comparing the choices of similar individuals in dissimilar circumstances it is possible to draw conclusions on the effects of incentives or age limits. Such arrangements created by pension reforms can be used in research more intensively than before.

Also different models are important for pension research. One reason for this is the fact that a pension scheme is a highly complex entity. Pension provision is affected by the individual's work and earnings history as well as by the detailed legislation on the pension scheme. In pension reforms several parts of the legislation are often changed simultaneously. In that case also the evaluation of the reform has to take into account several factors, which may even function in different directions. A model-based analysis is needed for these investigations. The aim is to build a so-called simulation model by using an individual panel dataset and pension legislation from different years. With this model we can analyse for instance the income distribution effects of different pension reforms.

The so-called overlapping generations models are important tools for pension research. The Finnish Centre for Pensions has supported the building and using of a numerical generation model at the Research Institute of the Finnish Economy (ETLA). Such a model will have an important task in pension research also in the future. Sustainability of the pension financing may be achieved in many

different ways and these different ways may have different effects on the level of pension provision as well as on the distribution of costs and benefits both between and within different generations. In order to evaluate and rank different alternatives, the kinds of analytical tools are needed which would enable a synchronised analysis of financial sustainability and generational effects.

## 4 Organisation of research

The earnings-related pension scheme is a part of the statutory social insurance, and the research activities of the Finnish Centre for Pensions are also based on law. Research is needed to evaluate the achievement of the goals of the statutory system and also to help to further develop the system.

### **RESEARCH PRINCIPLES OF THE FINNISH CENTRE FOR PENSIONS**

We react to the increasing need for research on development of the pension system and on population ageing.

We carry out reliable, high-quality and comprehensive research for decision-makers, experts and ordinary citizens.

We participate as experts in the public debate regarding the pension provision. We are also active in international research networks.

The research activities include both projects demanding long-term scientific approach and projects serving short- and mid-term decision-making in practice. The dual dimension of the activity is also reflected in its results. The core of the results consists of research reports released in the publication series of the Finnish Centre for Pensions. Other products include published articles, presentations and short memos. The growing importance of pension issues in the society shows in that different expert tasks in for instance working groups have appeared alongside the actual research work. Due to this growth of importance there is a growing demand in the public debate for research based results. The challenges may be considered very large in relation to the amount of available resources.

Moreover, we still need to improve the academic quality of the research. That direction is further influenced by the increased

formulation of pension policy at the EU level. This requires networking also outside one's own home country. Therefore researchers have to increasingly put an effort into following international research literature and trends, maintaining international research contacts and actively offering their own research results to international conferences. Increased internationalisation of the research leads to stricter requirements on the research, as only genuinely new results are considered truly interesting.

From the point of view of broadening pension research it is important that teaching and research activities at universities are broadened. However, at the moment there are rather few persons at universities who teach and tutor within this area of interest. Therefore it is useful that researchers within the pension system cover this gap for their part. This means both giving lectures at universities and assisting in the tutoring of thesis papers related to pension research. Another factor favouring increased cooperation with universities is the before mentioned increasing academic requirements of research.

A substantial amount of research is also done outside the Finnish Centre for Pensions which may directly or indirectly serve the development of the pension system. This type of research may provide new and broader viewpoints on the evaluation of the functioning of the pension system. Also otherwise it may be worthwhile to make use of readily available know-how from elsewhere in some special area in order to carry out certain projects. In many research areas success requires interaction between several researchers dealing with the same topic.

Following research done elsewhere and cooperating with the researchers of other research institutes is an integral part of the activity. Since there may be gaps in other researchers' knowledge of the pension scheme, the assistance of the Finnish Centre for Pensions



also for this research is important. The cooperation should take place in different forms. These may include joint projects where each participating party, for its part, participates in the financing of the project. The Finnish Centre for Pensions may also continue to finance research activities carried out elsewhere which serves the pension system. Moreover we may participate in the financing of more comprehensive projects together with other financiers.

Contacts and cooperation also with other research institutes within social and health care will be continued, and we will be active in the Network for European Social Policy Research (EUSO). The research seminars arranged at the Finnish Centre for Pensions provide a forum where also researchers outside the Finnish Centre for Pensions may present the results of their studies related to pension issues.

All in all, a growing interest is displayed towards pension provision and the research related to it. For instance the development in effective retirement age and the sustainability of the financing of pension provision are broadly relevant topics for the social and economic policy. Therefore it is important to develop means to increase and broaden interaction of pension research with other research fields of social sciences. This purpose is served by the founding of the scientific committee on research matters. It provides a regular form for cooperation with universities and research institutes, and it also serves the development of the personnel's competencies. In addition, interest group surveys are used to monitor how well the research knowledge gets through to the decision-makers and experts. In this connection it is also necessary to chart the wishes of the interest groups with regard to improving further the usefulness of the publications produced in the Finnish Centre for Pensions.